

**DEPARTMENT OF STATE REVENUE
LETTER OF FINDINGS: 07-0540P
Withholding Tax
For the Tax Years 2004-06**

NOTICE: Under IC § 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of the document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUE

I. Withholding Tax - Twenty-Percent Penalty.

Authority: IC § 2-5-3-1; IC § 6-3-2-2.8; IC § 6-3-4-13; IC § 6-8.1-5-1; IC § 6-8.1-10-2.1; 45 IAC 15-11-2; IT-20S Indiana S-Corporation Income Tax Booklet.

Taxpayer seeks abatement of the twenty-percent penalty for failure to file Form WH-1 and remit withholding tax on non-resident shareholders.

STATEMENT OF FACTS

Taxpayer is an S-Corporation. Taxpayer failed to file Form WH-1s for the years ending December 31, 2004, December 31, 2005, and December 31, 2006. The Indiana Department of Revenue ("Department") assessed a twenty-percent penalty for each year pursuant to IC § 6-8.1-10-2.1(h). Taxpayer protests the imposition of penalty. Further facts will be supplied as required.

I. Withholding Tax - Twenty-Percent Penalty.

DISCUSSION

Taxpayer believes that it is entitled to abatement of the twenty-percent penalty for failure to file Form WH-1. Taxpayer protests that it timely filed fiscal year end corporate IT-20S and IT-20COMP returns, which listed non-resident shareholders, along with checks covering all income tax due for fiscal years 2004, 2005, and 2006.

Pursuant to IC § 6-3-2-2.8:

Notwithstanding any provision of IC 6-3-1 through IC 6-3-7, there shall be no tax on the adjusted gross income of the following:

- (1) Any organization described in Section 501(a) of the Internal Revenue

Code, except that any income of such organization which is subject to income tax under the Internal Revenue Code shall be subject to the tax under IC 6-3-1 through IC 6-3-7.

(2) Any corporation which is exempt from income tax under Section 1363 of the Internal Revenue Code and which complies with the requirements of IC 6-3-4-13. However, income of a corporation described under this subdivision that is subject to income tax under the Internal Revenue Code is subject to the tax under IC 6-3-1 through IC 6-3-7. A corporation will not lose its exemption under this section because it fails to comply with IC 6-3-4-13 but it will be subject to the penalties provided by IC 6-8.1-10.

(3) Banks and trust companies, national banking associations, savings banks, building and loan associations, and savings and loan associations.

(4) Insurance companies subject to tax under IC 27-1-18-2, including a domestic insurance company that elects to be taxed under IC 27-1-18-2.

(5) International banking facilities (as defined in Regulation D of the Board of Governors of the Federal Reserve System (12 CFR 204)).

(Emphasis added).

According to IC § 6-3-4-13:

(a) Every corporation which is exempt from tax under IC 6-3 pursuant to IC 6-3-2-2.8(2) shall, at the time that it pays or credits amounts to any of its nonresident shareholders as dividends or as their share of the corporation's undistributed taxable income, withhold the amount prescribed by the department. Such corporation so paying or crediting any nonresident shareholder:

(1) shall be liable to the state of Indiana for the payment of the tax required to be withheld under this section and shall not be liable to such shareholder for the amount withheld and paid over in compliance or intended compliance with this section; and

(2) when the aggregate amount due under IC 6-3 and IC 6-3.5 exceeds one hundred fifty dollars (\$150) per quarter, then such corporation shall make return and payment to the department quarterly, on such dates and in such manner as the department shall prescribe, of the amount of tax which, under IC 6-3 and IC 6-3.5, it is required to withhold.

(b) Every corporation shall, at the time of each payment made by it to the department pursuant to this section, deliver to the department a return upon such form as shall be prescribed by the department showing the total amounts paid or credited to its nonresident shareholders, the amount withheld in accordance with the provisions of this section, and such other information as the department may require. Every corporation withholding as provided in this section shall furnish to its nonresident shareholders annually, but not later than the fifteenth day of the third month after the end of its taxable year, a record of the amount of tax withheld on behalf of such shareholders on forms to be prescribed by the department.

(c) All money withheld by a corporation, pursuant to this section, shall immediately upon being withheld be the money of the state of Indiana and every corporation which withholds any amount of money under the provisions of this section shall hold the same in trust for the state of Indiana and for payment thereof to the department in the manner and at the times provided in IC 6-3. Any corporation may be required to post a surety bond in such sum as the department shall determine to be appropriate to protect the state of Indiana with respect to money withheld pursuant to this section.

(d) The provisions of IC 6-8.1 relating to additions to tax in case of delinquency and penalties shall apply to corporations subject to the provisions of this section, and for these purposes any amount withheld, or required to be withheld and remitted to the department under this section, shall be considered to be the tax of the corporation, and with respect to such amount it shall be considered the taxpayer.

(e) Amounts withheld from payments or credits to a nonresident shareholder during any taxable year of the corporation in accordance with the provisions of this section shall be considered to be a part payment of the tax imposed on such nonresident shareholder for his taxable year within or with which the corporation's taxable year ends. A return made by the corporation under subsection (b) shall be accepted by the department as evidence in favor of the nonresident shareholder of the amount so withheld from the shareholder's distributive share.

(f) This section shall in no way relieve any nonresident shareholder from the shareholder's obligation of filing a return or returns at the time required under IC 6-3 or IC 6-3.5, and any unpaid tax shall be paid at the time prescribed by section 5 of this chapter.

(g) Instead of the reporting periods required under subsection (a), the department may permit a corporation to file one (1) return and payment each year if the corporation pays or credits amounts to its nonresident shareholders only one (1) time each year. The withholding return and payment are due on or before the fifteenth day of the third month after the end of the taxable year of the corporation.

(h) If a distribution will be made with property other than money or a gain is realized without the payment of money, the corporation shall not release the property or credit the gain until it has funds sufficient to enable it to pay the tax required to be withheld under this section. If necessary, the corporation shall obtain such funds from the shareholders.

(i) If a corporation fails to withhold and pay any amount of tax required to be withheld under this section and thereafter the tax is paid by the shareholders, such amount of tax as paid by the shareholders shall not be collected from the corporation but it shall not be relieved from liability for interest or penalty otherwise due in respect to such failure to withhold under IC 6-8.1-10.

(j) A corporation described in subsection (a) may file a composite adjusted gross income tax return on behalf of some or all nonresident

shareholders if it complies with the requirements prescribed by the department for filing a composite return.

(Emphasis added).

IC § 6-8.1-10-2.1 states:

(a) If a person:

- (1) fails to file a return for any of the listed taxes;
- (2) fails to pay the full amount of tax shown on the person's return on or before the due date for the return or payment;
- (3) incurs, upon examination by the department, a deficiency that is due to negligence;
- (4) fails to timely remit any tax held in trust for the state; or
- (5) is required to make a payment by electronic funds transfer (as defined in IC 4-8.1-2-7), overnight courier, or personal delivery and the payment is not received by the department by the due date in funds acceptable to the department; the person is subject to a penalty.

(b) Except as provided in subsection (g), the penalty described in subsection (a) is ten percent (10 [percent]) of:

- (1) the full amount of the tax due if the person failed to file the return;
- (2) the amount of the tax not paid, if the person filed the return but failed to pay the full amount of the tax shown on the return;
- (3) the amount of the tax held in trust that is not timely remitted;
- (4) the amount of deficiency as finally determined by the department; or
- (5) the amount of tax due if a person failed to make payment by electronic funds transfer, overnight courier, or personal delivery by the due date.

(c) For purposes of this section, the filing of a substantially blank or unsigned return does not constitute a return.

(d) If a person subject to the penalty imposed under this section can show that the failure to file a return, pay the full amount of tax shown on the person's return, timely remit tax held in trust, or pay the deficiency determined by the department was due to reasonable cause and not due to willful neglect, the department shall waive the penalty.

(e) A person who wishes to avoid the penalty imposed under this section must make an affirmative showing of all facts alleged as a reasonable cause for the person's failure to file the return, pay the amount of tax shown on the person's return, pay the deficiency, or timely remit tax held in trust, in a written statement containing a declaration that the statement is made under penalty of perjury. The statement must be filed with the return or payment within the time prescribed for protesting departmental assessments. A taxpayer may also avoid the penalty imposed under this section by obtaining a ruling from the department before the end of a particular tax period on the amount of tax due for that tax period.

(f) The department shall adopt rules under IC 4-22-2 to prescribe the circumstances that constitute reasonable cause and negligence for purposes of this section.

(g) A person who fails to file a return for a listed tax that shows no tax liability

for a taxable year, other than an information return (as defined in section 6 of this chapter), on or before the due date of the return shall pay a penalty of ten dollars (\$10) for each day that the return is past due, up to a maximum of two hundred fifty dollars (\$250).

(h) A corporation which otherwise qualifies under IC 6-3-2-2.8(2) but fails to withhold and pay any amount of tax required to be withheld under IC 6-3-4-13 shall pay a penalty equal to twenty percent (20 [percent]) of the amount of tax required to be withheld under IC 6-3-4-13. This penalty shall be in addition to any penalty imposed by section 6 of this chapter.

(i) Subsections (a) through (c) do not apply to a motor carrier fuel tax return. **(Emphasis added).**

Under IC § 6-8.1-5-1(b), “The burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made.” An assessment – including the negligence penalty – is presumptively valid.

Departmental regulation 45 IAC 15-11-2(b) defines negligence as “the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer.” Negligence is to “be determined on a case-by-case basis according to the facts and circumstances of each taxpayer.” *Id.*

IC § 6-8.1-10-2.1(d) allows the Department to waive the penalty upon a showing that the failure to pay the deficiency was based on “reasonable cause and not due to willful neglect.” Departmental regulation 45 IAC 15-11-2(c) requires that in order to establish “reasonable cause,” the taxpayer must demonstrate that it “exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed”

Pursuant to IC § 2-5-3-1:

It is hereby declared to be the policy of the general assembly of the state of Indiana to promote a revenue raising structure in Indiana that will provide adequate revenues to carry on the efficient operation of the state, county, and city governments and at the same time will assure that its burdens will be shared equitably by all taxpayers. It is further declared to be the policy of the general assembly of the state of Indiana to encourage and bring about the accomplishment of enforcement policies and administrative practices that will result in maximum return from existing taxes to the state of Indiana at a minimum cost to the taxpayers.

In imposing the twenty-percent penalty for failure to file Form WH-1 and remit withholding tax on non-resident shareholders the Department is enforcing a provision of the Indiana Code in order to ensure the continued compliance with Indiana law. The requirement of filing a Form WH-1 and the withholding on taxpayer’s non-resident shareholders is the state’s way of ensuring that the Department is provided with information it needs to carry out its objectives in the most efficient manner. The

withholding requirements imposed upon the taxpayer in this instance are more efficient than the unreasonably burdensome method of the Department trying to match non-resident shareholders to their respective S-Corporations in order to ensure that voluntary compliance with the Indiana tax laws has occurred.

Still, Taxpayer has provided documentation establishing that it filed composite returns which listed the non-resident shareholders for the S-Corporation. The IT-20S Indiana S-Corporation Income Tax Booklets for 2004, 2005, and 2006 each contain instructions for S-Corporations filing income tax returns. One relevant passage found at Page 19 of the 2006 IT-20S Indiana S-Corporation Income Tax Booklet states:

Composite filing does not negate the S corporation's requirement to file on a monthly, quarterly or annual basis Form WH-1 (Employer's Withholding Tax Return), used for submitting withholding tax payments for all nonresident shareholders along with any withholding for employees.

The Booklets for 2005 and 2004 have identical provisions. These IT-20S Indiana S-Corporation Income Tax Booklets also provide instructions for S-Corporations to report single distribution income to non-resident shareholders. The relevant passage found on Page 4 of the 2006 IT-20S Indiana S-Corporation Income Tax Booklet states:

However, an S corporation having one distribution credited to shareholders during the year or at the close of the S corporation's fiscal year may be permitted to file Form DB020W-NR. This creates a nonresident withholding account if one does not exist, and allows the respective state and county withholding tax amounts on nonresidents to be paid at one time when a nonresident withholding account that is separate from the payroll withholding account is established. This withholding return, a copy of which is included in this booklet, is due by the fifteenth day of the third month following the end of the taxable year (e.g., if a single annual distribution for a calendar year is made on Dec. 31, 2006, the withholding tax is due March 15, 2007). Advances or drawings against a shareholder's distributive share of income are deemed paid on the last day of the S corporation's tax year.

In the instant case, Taxpayer did not file a WH-1 or a DB020W-NR. However, Taxpayer did list its non-resident shareholders, and did collect and remit tax for the years at issue. While the IT-20S Indiana S-Corporation Income Tax Booklets for 2004, 2005, and 2006 caution taxpayers that filing a composite return does not relieve the burden of filing a WH-1, the Booklets also provide alternate methods of reporting withholding. Since Taxpayer did file returns which listed the non-resident shareholders and since Taxpayer remitted the tax due for the years at issue, the Department will waive the penalty found at IC § 6-8.1-10-2.1(h). However, for future tax years, Taxpayer will be required to file either WH-1

returns or DB020W-NR forms. Taxpayer has met its burden under IC § 6-8.1-5-1(b) and 45 IAC 15-11-2(c).

FINDING

Taxpayer's protest is sustained for the years 2004, 2005, and 2006. Taxpayer will be required to file WH-1 or DB020W-NR forms for following years.

WL/LS/DK January 14, 2008